

Sörmlands Sparbank

Full Rating Report

LONG-TERM RATING

BBB+

OUTLOOK

Positive

SHORT-TERM RATING

N-1+

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RATING RATIONALE

Our 'BBB+' long-term issuer rating on Sweden-based Sörmlands Sparbank reflects the bank's very strong capital position, low risk appetite, and relationship-based funding profile. We view the bank's cooperation arrangement with Swedbank AB as positive, as it provides material diversification of product offerings, shared IT costs and the opportunity to finance retail mortgages. In addition, Sörmlands Sparbank benefits from dividend revenues through its holdings of Swedbank shares, which have resumed in 2021.

The rating is constrained by the bank's relatively weak core earnings metrics, which remain weaker than those of similar Nordic savings banks. The rating also reflects the relative volatility of the bank's local market, which has historically demonstrated volatility associated with being a key region for Sweden's manufacturing industry. Despite the uncertain economic environment, our projections for losses and non-performing loans are only slightly above historic levels after the resolution of a small number of legacy credit losses have been resolved in the past year.

POSITIVE OUTLOOK

Our positive outlook on Sörmlands Sparbank reflects our expectation that the bank will continue to improve its core earnings metrics, while maintaining strong capital ratios as it grows its loan book. It also takes account of the bank's maintenance of its relationship with Swedbank and its low risk appetite, with normalised credit losses as the local economy improves.

POSITIVE RATING DRIVERS

- Sustainable improvements in core earnings metrics, with core pre-provision income to risk exposure above 1.5%.
- Continued improvement in the economic conditions in Sweden and in the bank's local market.
- Asset quality metrics in line with the peer group.

DRIVERS FOR A STABLE OUTLOOK

- Core earnings metrics fall below our estimates.
- The bank's growth plans leading to a sustained reduction in the common equity capital ratio to below 21%.
- Material deterioration in asset quality metrics.

Figure 1. Sörmlands Sparbank key credit metrics, 2017–2023e

%	2017	2018	2019	2020	2021e	2022e	2023e
Net interest margin	1.4	1.4	1.5	1.6	1.4	1.4	1.4
Loan losses/gross loans	0.06	0.12	-0.06	-0.31	-0.19	0.07	0.06
Core pre-provision income/REA	0.7	0.2	0.6	1.0	1.1	1.3	1.5
Return on equity	5.9	3.0	5.0	3.8	6.4	4.8	5.4
Loan growth	5.5	9.8	-1.2	11.1	13.0	11.5	11.5
CET1 ratio	20.4	21.6	22.1	21.9	22.3	21.7	21.3

Based on NCR estimates and company data. e–estimate. REA–risk exposure amount. CET1–common equity Tier 1. Core pre-provision income includes only net interest income and net fee and commission income. All metrics adjusted in line with NCR methodology.

ISSUER PROFILE

Sörmlands Sparbank was initially founded in 1832 as Nyköpings Sparbank and took its current form via a 1991 merger and the 1998 acquisition of five local bank offices as part of the creation of Föreningssparbanken (now Swedbank). Sörmlands Sparbank is based in Katrineholm in the county of Södermanland (also called Sörmland). The bank is also active in the municipalities of Nyköping, Flen, Vingåker and Oxelösund. These communities have a total of about 130,000 inhabitants in southern Södermanland, stretching from Lake Hjälmaren to the west and the Baltic Sea to the east.

In 2022, Sörmlands Sparbank will become a limited liability company, and will be renamed Sörmlands Sparbank AB (publ) and be wholly owned by a newly created foundation, Sparbanksstiftelsen Sörmland. This will allow the bank to increase its distributions to the local economy via its owner. Like most Swedish savings banks, the bank shares a history of cooperation with Swedbank, which provides material product diversification, shared costs on IT solutions, and the opportunity to finance retail mortgages via Swedbank Hypotek AB, Sweden's largest issuer of covered bonds.

Figure 2. Sörmlands Sparbank core markets

Municipality	Population, June 2021	Expected population change, 2021–2040	Unemployment, Sept. 2021	Unemployment, Sept. 2020
Katrineholm	34,769	6.0%	9.5%	10.5%
Nyköping	57,310	7.3%	8.6%	10.0%
Flen	16,410	-7.3%	13.1%	14.4%
Vingåker	9,097	-4.4%	9.6%	10.6%
Oxelösund	12,041	4.2%	10.1%	12.2%
Sweden	10,327,600	8.9%	7.5%	8.9%

Source: Statistics Sweden, Arbetsförmedlingen (Swedish Public Employment Service).

OPERATING ENVIRONMENT

Operating environment assessment is 'bbb'

NCR considers a balance of national and regional factors in our assessment of Sörmlands Sparbank's operating environment. The bank operates in a narrow market, with a high share of its exposures associated with the local economy, which has higher unemployment and has proven to be more volatile than the Swedish average, given the importance of the manufacturing sector.

Swedish banking assessment raised on reduced COVID threat

National factors score 'a-'

In September this year, NCR raised its assessment of the Swedish banking market to 'a-' from 'bbb+' (see also [Nordic banking assessments raised on reduced COVID threat](#), 9 Sep. 2021). Our assessment is back at the pre-pandemic level to reflect expectations that vaccination rates will increase and lead to a reduction in pandemic-related restrictions. Once restrictions are fully removed, we anticipate increased economic activity in both cyclical production segments and service industries. We also expect that the ongoing economic recovery will result in lower unemployment, especially among young adults, who have been disproportionately affected by a loss of service and seasonal work. Sweden's strong public finances and lower-than-projected budget deficit, together with expansionary monetary policies, provide buffers against threats to economic recovery.

The Swedish regulator will increase the countercyclical buffer in June 2022, signalling a more positive outlook for the banking sector. The increased pace of housing price growth during the pandemic has proven to be unsustainable and NCR continues to believe that the pace of housing price growth will align itself with the market's long-term growth rate for the remainder of 2021 and in 2022, in part due to the continued rollout of COVID-19 vaccines, but also due to the reinstatement of amortisation requirements.

Reduced unemployment improving local operating environment

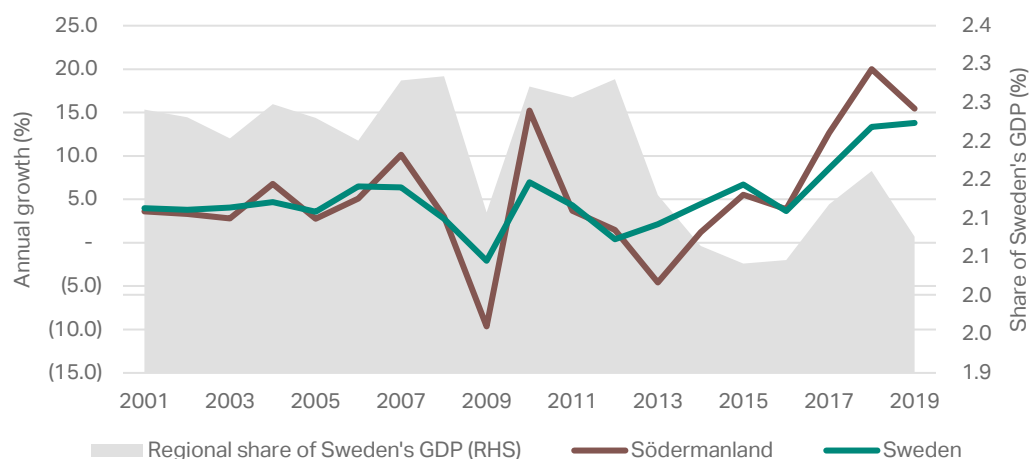
Regional, sectoral, and cross-border factors score 'bbb-'

Sörmlands Sparbank's base is in southern Södermanland county, excluding Eskilstuna and Strängnäs, which fall within the domain of Sparbanken Rekarne AB, and excluding Trosa and Gnesta, which are in Swedbank's domain. With the exception of Nyköping, the bank's core markets are largely dependent on manufacturing, which suffered a 15%–20% decline in production in March and April 2020 at the

outbreak of the COVID-19 pandemic, but has rebounded, despite ongoing issues with the global supply chain. Employment levels have materially improved over the last year in each of the bank's core markets (see Figure 2), but we note that Södermanland county continues to have the highest unemployment rate in Sweden, at 10.1% (9.5% in August 2019).

Prior to the onset of COVID-19, the county, which accounts for about 2% of the Swedish economy, had experienced economic growth above national averages, but suffered a material setback due to the pandemic. As the impact of the pandemic recedes, the region is well positioned to benefit from the increase in employees working from home, which has had a material impact on municipality level population projections over the last two years. The bank's region is mostly within an hour of Stockholm city centre by train, and housing prices in the market are considerably lower than in the capital region.

Figure 3. Södermanland's annual economic growth and regional share of Sweden's GDP, 2001–2019



Source: Statistics Sweden.

RISK APPETITE

Risk appetite assessment is 'a'

Sörmlands Sparbank has a low risk appetite, given its significant capital buffers and retention of earnings on the balance sheet. Its liquidity buffers are strong and the bank has a relationship-based funding profile with the ability to transfer mortgage loans to Swedbank Hypotek. As with many of its peers, the bank has natural portfolio concentrations in its local market, and particularly in real estate.

Risk governance and ESG efforts are improving

Risk governance scores 'bbb+'

Sörmlands Sparbank's regional focus creates naturally high geographic risk concentrations and the bank's risk governance is less developed than that of larger Nordic banks. However, we view the bank's risk appetite, limit monitoring, risk reporting, and overall governance is in line with the larger savings banks, given investments in risk framework and related staffing following a regulatory sanction in 2017.

In our view, Sörmlands Sparbank's primary environmental, social and governance (ESG) attribute is its strong sense of social responsibility in its local communities. The bank has contributed over SEK 125m to local education, youth sports, integration and cultural projects since 1999. The bank has committed to work towards the UN's goals for responsible consumption, sustainable lending practices and fair and equal employment opportunities.

Sörmlands Sparbank has climate neutral status, according to the Greenhouse Gas Protocol, an international environmental watchdog. This status reflects the bank's efforts to limit its own emissions and compensate for excess emissions to neutralise its environmental footprint. In addition, the bank incorporates ESG reviews into all credit decisions exceeding SEK 5m.

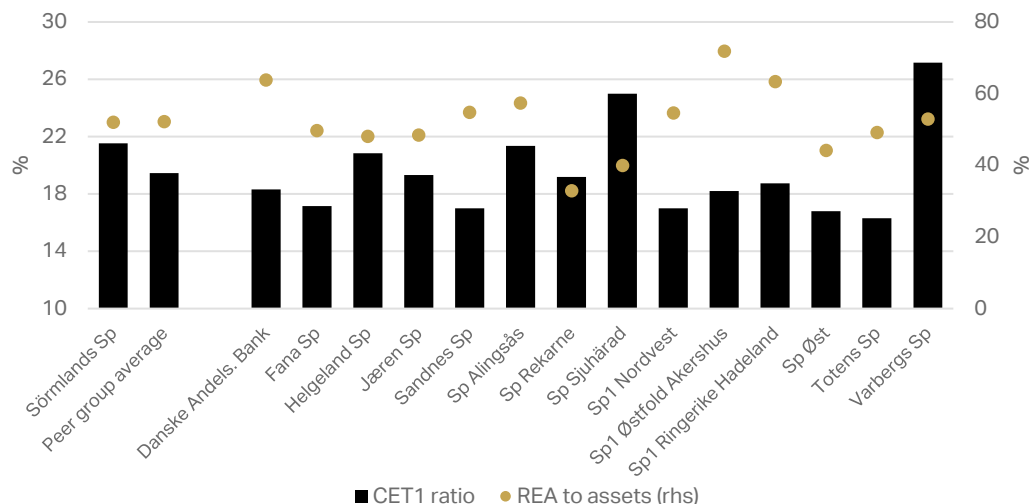
Capitalisation improvements driven by material loss reversals and Swedbank dividends

Capital scores 'aa-'

Sörmlands Sparbank's CET1 capital ratio was 21.5% as of 30 Jun. 2021 (23.0% including year to date profit), more than double the current regulatory requirement. Our forecast projects that the ratio will decline, reflecting on-balance-sheet loan growth of 11%–12% per year and expectations of increased

dividends following the reorganisation as a limited liability company. We expect the increased scale to steadily improve cost efficiency and include about SEK 60m per year in Swedbank dividends in 2022 and 2023 (see Earnings Performance below). The bank uses standardised capital models and total equity accounts for 17.3% of total assets, which is strong even among well-capitalised Nordic savings banks, but includes holdings in Swedbank, which are deducted from regulatory capital.

Figure 4. Sörmlands Sparbank REA/asset and CET1 ratios, 30 Jun. 2021



Source: company reports. Sp-Sparbank (Sweden)/Sparebank (Norway).

Sörmlands Sparbank's regulatory capital base excludes all its holdings of Swedbank shares that exceed 10% of its own CET1. As of 30 Jun. 2021, the amount deducted from the capital base stood at SEK 811m of the SEK 1,046m market value on the balance sheet. We note that Swedbank's share price has recovered many of its valuation losses since money laundering accusations were levied in February 2019, adding material buffers to the already strong regulatory capital position of Sörmlands Sparbank.

Funding dominated by customer deposits; liquidity strong

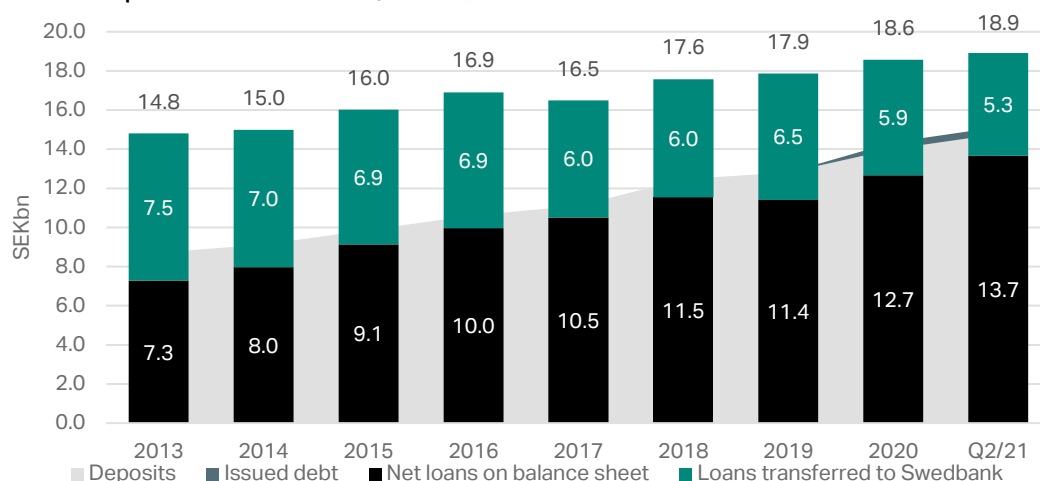
We regard Sörmlands Sparbank's funding and liquidity position as relative strengths. Existing liquidity buffers are strong and the bank has a high level of relationship-based retail deposits and the ability to transfer mortgage loans to Swedbank Hypotek. As of 30 Jun. 2021, the bank's net stable funding ratio was a robust 143% and the liquidity coverage ratio is regularly above 300%, well above regulatory and internal limits.

Increased savings in Sweden since the outset of the pandemic have maintained the bank's loan-to-deposit ratio at 92% as of 30 Jun. 2021, even as the loan book grows. The bank has historically maintained a strong liquidity buffer of over 30% of customer deposits, of which 73% were from what we view as loyal household customers. Despite an excess of customer deposits, the bank issued its first bond in November 2020 and we expect it to resume bond issuance to support growth and further diversify its funding.

Sörmlands Sparbank's cooperation with Swedbank also provides various funding benefits. The bank can transfer residential mortgages to Swedbank Hypotek, in return for a commission. The bank's current strategy is to increase its own balance sheet lending relative to loans transferred to Swedbank, with most new lending growth on the bank's own balance sheet (see Figure 4). We believe the bank will continue to grow its total loans volume and to repatriate transferred loans to its own balance sheet, given its strong liquidity.

Funding and liquidity scores 'a'

Figure 5. Sörmlands Sparbank net loans (on own balance sheet and transferred to Swedbank), customer deposits and issued debt, 2013-Q2 2021



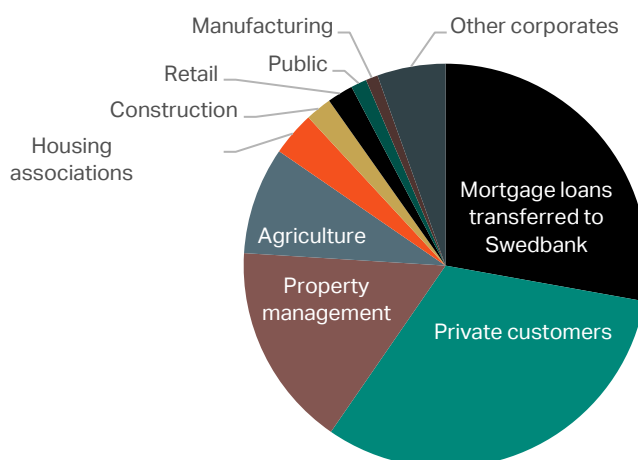
Source: company.

Credit risk concentrated on property lending in the bank's region

Some 80% of Sörmlands Sparbank's customer base is located within the bank's five core markets, leading to a material concentration of local real-estate collateral. Nearly 90% of total loan exposure is collateralised by private housing, housing cooperatives, agriculture or commercial real-estate management and construction (including SEK 5.3bn in transferred mortgages) (see Figure 6). Housing prices and real-estate values in the region have increased in line with the Swedish market, supporting the bank's collateral, and lending to the agricultural sector is highly diverse, with a high proportion extended to family-owned farms and forest owners.

In addition, Sörmlands Sparbank's lending is focused on private individuals and SMEs with primary operations and employment in their own core markets, which leads to geographical concentration. The manufacturing industry is a significant employer in the region and, despite a low share of loans to manufacturing, many of the bank's exposures can be affected by volatility of the region's largest manufacturers. Geographic concentrations are mitigated by rail and highway access to larger employment markets in the Stockholm region, as well as Eskilstuna, Norrköping and other nearby cities. The bank has relatively low exposure to high-risk industries, with modest exposures to construction, retail, and hotels and restaurants.

Figure 6. Sörmlands Sparbank total net lending by segment, 30 Jun. 2021



Source: company.

Sörmlands Sparbank's SEK 5.3bn in transferred mortgage loans to Swedbank provides income via commission fees. The bank has a first-loss risk associated with the transferred loans that results in a reduction in paid commission when loss reserves are necessary for transferred loans. The maximum

Credit risk scores 'bbb'

risk on transferred loans is about SEK 50m per year, or the amount of reported loan commission income.

Market risk low; other risk not a material concern

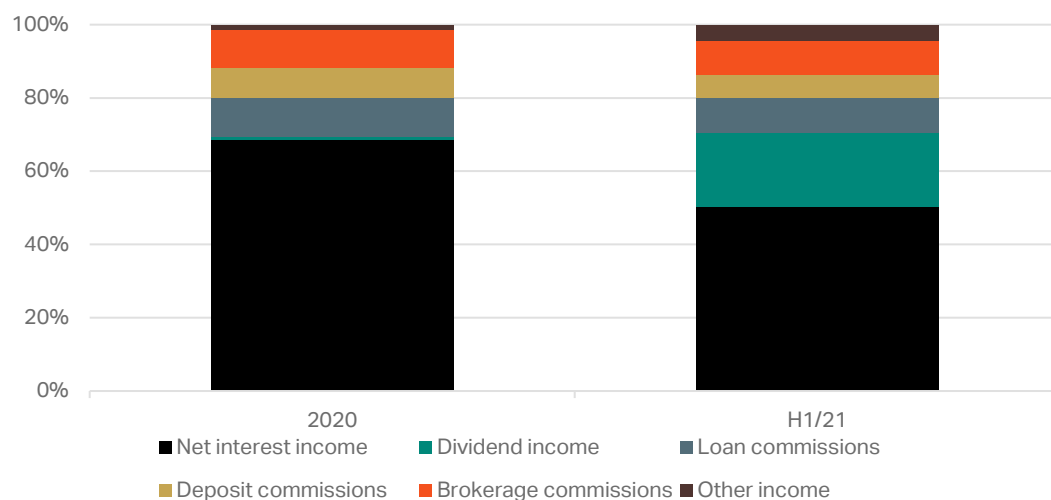
In our view, market risk is not a material risk factor for the bank. The bank's securities consist primarily of covered bonds and bonds issued by municipalities and the Swedish government as part of the bank's liquidity buffers. The bank has low limits for interest rate risk and has immaterial foreign currency exposure. It maintains a derivative portfolio solely for interest rate hedging purposes.

Sörmlands Sparbank's ownership of Swedbank shares ensures it has a meaningful voice alongside other savings banks that own shares, either directly or via their owner foundations. We consider the importance of Swedbank dividends in our assessment of Sörmlands Sparbank's earnings performance. Aside from Swedbank shares, the bank has strategic ownership in fund company Indecap Holding AB (jointly owned along with over 35 other savings banks) and insurance company Sparbankernas Försäkring AB (with over 50 other savings banks).

COMPETITIVE POSITION

Sörmlands Sparbank has a strong position in its core markets, with a market share of around 30% in Nyköping and nearly 60% in Katrineholm and its other core markets. The bank's primary local competition comes from Länsförsäkringar Bank, while larger corporations in the region are serviced by the country's larger banks. Increased competition from larger banks, challenger mortgage institutions and nearby savings banks is affecting the bank's local margins, but has not materially impacted its ability to attract and retain customers, in our view. At national level, the bank accounts for about 0.3% of total deposits and total loans, including loans transferred to Swedbank.

Figure 7. Sörmlands Sparbank income composition, 2020 and 2021H1



Source: company.

PERFORMANCE INDICATORS

Our analysis of Sörmlands Sparbank's earnings is focused on core revenues, excluding financial gains and losses, dividends and other non-core income. We note the bank's earnings are also buoyed by dividends from its strategic holdings in Swedbank and have benefitted from nearly SEK 100m in loan loss reversals since mid-2020. We project improvements in scale and cost efficiency to improve the earnings profile from below its Swedish peer group average to within its peer group over time, but view earnings as a relative weakness. Our expectations for losses are in line with long-term normalised levels, reflecting the resolution of legacy non-performing loans over the last 18 months, which materially reduces non-performing loans.

Earnings well below peer group average, but likely to improve due to accelerated cost focus

The bank's earnings metrics remain weaker than those of similar savings bank peers, especially when adjusted for Swedbank dividends. However, as we anticipated, improvement in Sörmlands Sparbank's core earnings began with cost measures taken in 2020 and fully impacting from 2021. While the bank

Other risks score 'a'

Competitive position assessment is 'bbb'

Performance indicators assessment is 'bbb'

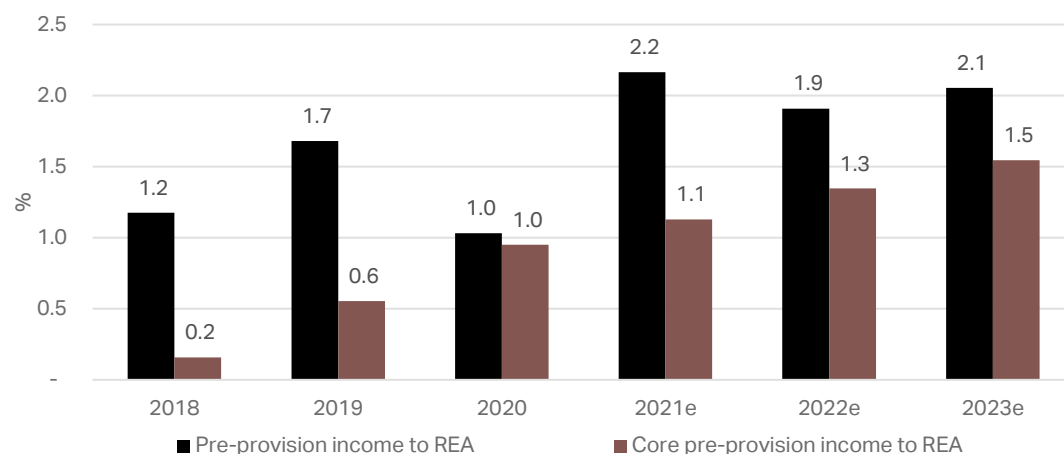
Earnings scores 'bb'

has outpaced our expectations for 2020, we have adjusted our expectations for core risk-adjusted earnings down in 2021 and 2022 to reflect expectations of less aggressive cost reductions and higher margin pressure than previously anticipated.

Nevertheless, the bank's earnings were significantly boosted in 2021 by the reinstated dividends from Swedbank, totalling in excess of SEK 100m. We expect Swedbank to pay out 50% of profits from 2022 onward. Our forecast includes about SEK 60m paid out in 2022 and 2023. See [Swedish savings banks get dividend boost after solid 2020](#), 21 Jun. 2021 for further details of the impact of Swedbank's dividends and [Q&A: Swedbank judgement and share price impacts on Swedish savings banks](#), 23 Mar. 2020 for details of how movements in the Swedbank share price affect Sörmlands Sparbank and other Swedish savings banks.

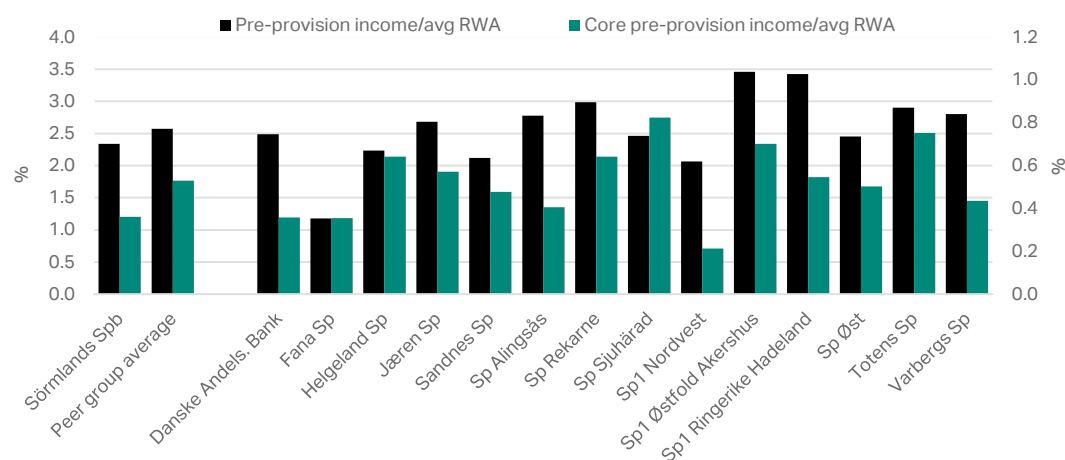
We note that Sörmlands Sparbank is making improvements in cost efficiency and projects a core cost-to-income ratio of under 60% by 2025 (compared with 87% in 2019 and 77% in 2020). Our forecast anticipates a 69% core ratio in 2022, due to expectations that further cost reductions could be more difficult, in part because of increased costs of the restructuring. The bank's plan includes increased use of digital customer channels, the completion of the merger of the bank's Nyköping branches, and the full impact of the reduction in headcount in 2020. We expect the bank to approach its Nordic savings bank peer group's core risk-adjusted earnings by year-end 2023 (see figures below).

Figure 8. Sörmlands Sparbank pre-provision income to risk exposure amount, 2018-2023e



Source: company. Core revenues include only net interest income and net fee & commission income.

Figure 9. Nordic savings banks' risk-adjusted earnings, 2021H1 annualised



Source: company reports. Spb-Sparbank(en). *Use of IRB models in capital calculations. Core pre-provision income takes account of only net interest income and net fee and commission income.

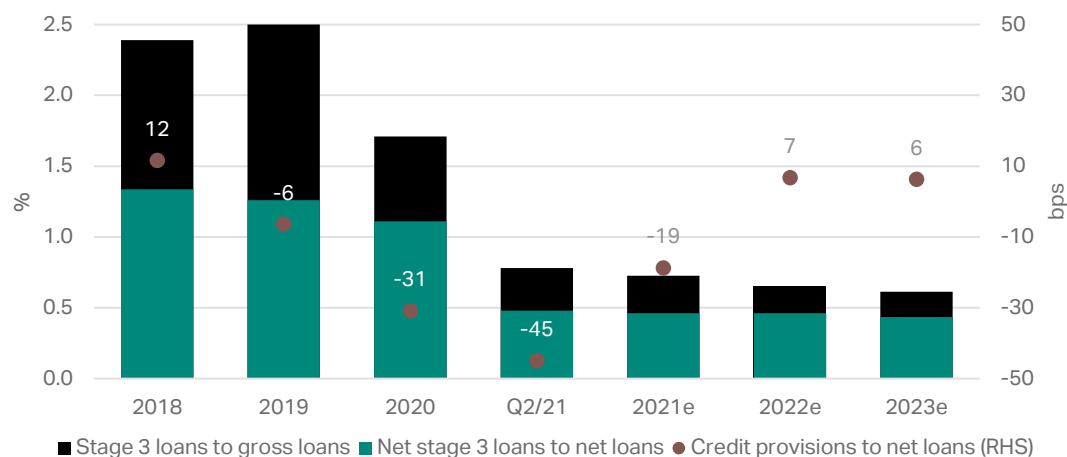
Loss performance
scores 'a-'

Non-performing loans and credit losses expected to return to levels in line with peers

Sörmland Sparbank's recent loan losses have been affected by a 2016 legacy exposure, which led to a 75bps credit loss in 2016 and large recoveries in 2020 and the first half of 2021. The resolution of the loss since 2020 has also had a material impact on the bank's Stage 3 non-performing exposures, which our forecast projects will fall further to around 65bps of gross loans, in line with the average of its Swedish savings bank peer group.

In the 12 months to June 2021, the bank made reversals of SEK 90m, primarily due to the resolution of legacy exposures. We project that the bank will have more stable losses going forward, around our loss expectations for the peer group, given the low exposure to at-risk industries and a diminishing impact of the pandemic.

Figure 10. Sörmlands Sparbank asset quality metrics, 2018–2023e



Source: company, e-estimate.

ADJUSTMENT FACTORS

Peer comparison

Peer comparison is
neutral

We believe that Sörmlands Sparbank's relative strengths and weaknesses are accurately reflected in our 'bbb+' initial credit assessment. NCR has confidential credit assessments (not full credit ratings) on nearly 300 Nordic banks. The average assessment is 'bbb+', reflecting a high level of savings banks in the sample.

Support analysis

Support analysis is
neutral

Sörmlands Sparbank has no owners. Instead, it has 50 principals. The principals appoint a board and distribute the bank's profit. Given the bank's current structure, there is no additional owner capital held in a foundation or within Swedbank, which is the case at a number of other Swedish savings banks.

In April 2021, Sörmlands Sparbank decided to reorganise itself as a limited liability company, with a savings bank foundation (*sparbanksstiftelse*) as owner, in line with the structure of many other Swedish savings banks. Pending regulatory approval, the bank will be renamed Sörmlands Sparbank AB (publ) and will be wholly owned by a newly created foundation, Sparbanksstiftelsen Sörmland. The restructuring is scheduled to take place in 2022 and will not affect our ratings on the bank, nor our view on ownership support.

ISSUE RATINGS

Our rating on Sörmland Sparbank's unsecured senior debt is in line with the issuer rating, i.e. 'BBB+'. We rate senior unsecured bonds issued under the bank's medium-term note programme 'BBB+', an indication of our ratings on future issuance from the programme.

Figure 11. Sörmlands Sparbank key financial data, 2016–Q2 2021 YTD

Key credit metrics (%)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Q2 2021 YTD
INCOME COMPOSITION						
Net interest income/op. revenue	50.9	41.2	48.3	49.7	65.0	50.3
Net fee income/op. revenue	23.7	31.7	31.4	28.9	33.1	28.8
Net trading income/op. revenue	4.0	5.2	-2.2	0.4	-0.1	0.4
Net other income/op. revenue	21.4	21.9	22.5	21.0	2.0	20.5
EARNINGS						
Net interest margin	1.5	1.4	1.4	1.5	1.6	1.4
Pre-provision income/REA	0.1	2.2	1.2	1.7	1.0	2.3
Return on ordinary equity	-2.1	5.9	3.0	5.0	3.8	9.6
Return on assets	-0.4	1.2	0.6	0.9	0.6	1.6
Cost-to-income ratio	96.6	58.8	76.5	68.0	75.9	56.9
Cost-to-income ratio, ex. trading	100.7	62.1	74.9	68.3	75.9	57.1
CAPITAL						
CET1 ratio	17.4	20.4	21.6	22.1	21.9	21.5
Tier 1 ratio	17.4	20.4	21.6	22.1	21.9	21.5
Capital ratio	17.4	20.4	21.6	22.1	21.9	21.5
REA/assets	64.8	59.0	55.0	56.3	54.1	52.0
Dividend payout ratio						
Leverage ratio	13.5	13.5	13.1	12.4	11.8	11.1
GROWTH						
Asset growth	8.8	3.0	10.9	-0.0	10.4	6.4
Loan growth	9.1	5.5	9.8	-1.2	11.1	7.8
Deposit growth	7.7	4.6	12.2	2.7	9.1	5.7
LOSS PERFORMANCE						
Credit provisions to net loans	0.76	0.05	0.12	-0.06	-0.31	-0.45
Impaired loans to gross loans	2.11	2.12	2.28	2.51	1.63	0.76
Net impaired loans to gross loans	1.00	1.08	1.19	1.12	0.87	0.31
Net problem loans to equity	3.58	4.05	4.79	4.85	3.95	1.40
Non-performing loan coverage ratio	52.65	48.97	47.84	55.29	46.89	58.94
Stage 3 loans/gross loans		2.51	2.28	2.51	1.63	0.76
Net stage 3 loans/net loans		1.47	1.34	1.26	1.11	0.48
FUNDING & LIQUIDITY						
Loan/deposit ratio	93.8	94.6	92.5	89.0	90.6	92.4
Net stable funding ratio	0.0	0.0	0.0	0.0	155.0	143.0
Liquidity coverage ratio	224.0	350.0	406.0	410.0	375.0	332.0

Key financials (SEKm)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Q2 2021 YTD
BALANCE SHEET						
Total assets	13,830	14,240	15,798	15,796	17,432	18,547
Total tangible assets	13,830	14,240	15,798	15,796	17,432	18,547
Total financial assets	13,585	14,031	15,591	15,621	17,286	18,365
Net loans and advances to customers	9,964	10,510	11,542	11,407	12,672	13,657
Total securities	2,865	2,629	2,722	2,413	2,464	2,543
Customer deposits	10,625	11,115	12,476	12,817	13,986	14,781
Issued securities					350	350
of which covered bonds						
of which other senior debt					350	350
of which subordinated debt						
Total equity	2,812	2,843	2,906	2,678	2,803	3,032
Total ordinary equity	2,812	2,843	2,906	2,678	2,803	3,032
CAPITAL						
Common equity tier 1	1,562	1,714	1,883	1,963	2,069	2,079
Tier 1	1,562	1,714	1,883	1,963	2,069	2,079
Total capital	1,562	1,714	1,883	1,963	2,069	2,079
REA	8,966	8,404	8,696	8,898	9,437	9,652
INCOME STATEMENT						
Operating revenues	378	460	429	462	393	257
Pre-provision operating profit	13	189	101	148	95	111
Impairments	96	6	13	-7	-37	-30
Net Income	-57	167	87	141	104	140

Source: company. FY–full year. YTD–year to date.

Figure 12. Sörmlands Sparbank rating scorecard

Subfactors	Impact	Score
National factors	10.0%	a-
Regional, cross border, sector	10.0%	bbb-
Operating environment	20.0%	bbb
Capital	17.5%	aa-
Funding and liquidity	15.0%	a
Risk governance	5.0%	bbb+
Credit risk	10.0%	bbb
Market risk	-	-
Other risks	2.5%	a
Risk appetite	50.0%	a
Market position	15.0%	bbb
Earnings	7.5%	bb
Loss performance	7.5%	a-
Performance indicators	15.0%	bbb-
Indicative credit assessment		bbb+
Transitions		Neutral
Peer comparisons		Neutral
Borderline assessments		Neutral
Stand-alone credit assessment		bbb+
Material credit enhancement		Neutral
Rating caps		Neutral
Support analysis		Neutral
Issuer rating		BBB+
Outlook		Positive
Short-term rating		N-1+

Figure 13. Capital structure ratings

Seniority	Rating
Senior unsecured	BBB+

DISCLAIMER

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